

## A.I.D. EVALUATION HIGHLIGHTS NO. 8

A.I.D. Export and Investment Promotion Programs in Latin America and the Caribbean: Sustainability and Effective Service Delivery  
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### Summary

For more than a decade, the Agency for International Development (A.I.D.) has made support to institutions promoting exports and investment in developing countries a focal point of its strategy for private sector assistance. During this period, A.I.D. has provided more than a quarter of a billion dollars to support these institutions in Latin America and the Caribbean alone. The central questions for A.I.D. decision-makers are simply stated:

Do trade- and investment-promotion organizations merit continued support from A.I.D.? And, if so, which programs have the most impact on exports and investment?

A recent study, sponsored by A.I.D.'s Center for Development Information and Evaluation (CDIE) and the Bureau for Latin America and the Caribbean (LAC), examines the experience of promotional institutions in the Dominican Republic, Guatemala, Costa Rica, and Chile to answer these questions. It focuses on 10 promotional institutions in these countries and arrives at three important conclusions:

1. Promotional institutions can make a modest but important contribution to building nontraditional exports in a favorable policy environment, and their services can accelerate the process of export growth. Support to these institutions also offers an attractive return to donor resources. But the experiences examined suggest that the total impact of promotional programs on nontraditional exports at the national level is likely to be marginal, unless the investment is large relative to national exports and is made in a sector poised for take-off.

2. An important service a promotional institution can provide is information, particularly foreign market information and buyer contacts. However, given the different information requirements of local exporters and foreign investors, investment promotion programs should not be combined with export promotion programs.

3. Promotional institutions are not effective substitutes for policies favoring export-oriented investment. In a policy environment attractive to export investment, such institutions speed the process whereby firms learn of profitable opportunities and take advantage of them. But if there are no opportunities for

profitable investment, there is nothing to promote.

## Background

Recent world events have focused on the importance of outward-oriented economies to economic growth and development. Countries with strong trade, investment, and export systems have achieved better development results than inward-oriented economies. For A.I.D., promotion of trade and investment in developing countries has been a primary focus of the Agency's Private Sector Initiative since the early 1980s. In the Latin America and Caribbean (LAC) region, trade and investment projects have formed a major part of A.I.D.'s private sector assistance portfolio. Given their importance, CDIE, jointly with the LAC Bureau, initiated a major assessment of the Agency's experience with trade and investment projects in Latin America and the Caribbean, the region where two-thirds of A.I.D.'s export- and investment-promotion projects have been implemented.

Three factors prompted the study. First, because A.I.D. has been a critical force behind the establishment of export and investment promotion institutions, managers wanted to determine whether continued subsidies are warranted. Second, the volume of A.I.D. resources committed to trade and investment projects is large and growing. Third, A.I.D. has a continuing commitment to supporting export-led growth in developing countries.

The study examines five issues that together determine whether promotional institutions are worth supporting and how their programs should be structured for maximum impact on exports, investment, and jobs:

**Firm-level impact:** Do these institutions have an impact on the firms they assist?

**National-level impact:** Do they have an impact on export and foreign investment at the national level?

**Economic return:** Is support to these institutions economically attractive and cost-effective?

**Service mix:** What service strategies appear to have the greatest impact?

**Institutional structure:** What institutional models appear to offer the best vehicles for delivering services?

A key assumption of the study is that policy is critical to export growth and that without a favorable policy environment, programs targeting services to exporters and investors cannot be effective. It therefore targets institutions with good programs working in policy environments favorable to export-led growth. In particular, the study focuses on 10 promotional institutions in four countries that experienced rapid growth in nontraditional exports between 1983 and 1989: Costa Rica, the Dominican Republic, Guatemala, and Chile. Each country enjoyed a policy environment relatively

favorable to export growth, evident in its exchange rate policy, which closely tracks the variations in the country's nontraditional export performance.

The study also targets programs with sufficiently long track records to make impact analysis meaningful. The institutions examined (seven in the CBI region and three in Chile) include both established organizations and institutions whose creation was directly related to A.I.D. sponsorship and funding (see box). Finally, to assess firm-level impact, the study relies heavily on a survey of 162 exporting firms in the four countries in the agricultural and light manufacturing sectors, including 110 firms assisted by the promotional institutions and 52 unassisted firms as a control group for comparison. The object of the survey was to determine which services exporters and investors actually used and which services had the greatest impact on the firms' efforts to export or to invest in an exporting firm. The services examined fell into five broad categories: information, private contact-making (e.g., buyer contacts), investment and export support (e.g., site visits, accounting, legal services), technical assistance, and government facilitation.

### Approach

A.I.D. trade and investment projects in the LAC region encompass a wide range of objectives, from promoting nontraditional agricultural exports, to promoting investment in light manufacturing exports, and even to promoting some combination of the above. The study identifies the three key elements that distinguish one approach from another, which are also the elements most critical to a viable strategy for expanding exports and investment: (1) the clientele, (2) the service strategy, and (3) the institutional structure.

**Clientele:** Local exporters of nontraditional crops and foreign investors in light manufacturing exports require different services. Given the diverse clientele, the nature of the service has to be sector- and product-specific.

**Service Strategy:** Services can be standardized, provided in the same form to a large number of clients, or customized, provided to meet the needs of the individual client. The level of technical support required and cost are two considerations in assessing the appropriateness of different strategies.

**Institutional Structure:** The delivery mechanisms for export and investment promotion range from membership organizations, to government agencies, to independent private entities, or to project implementation units. Each type plays a role in determining the sustainability, the autonomy, and the responsiveness of different approaches.

The study suggests that the needs of the specific clientele drive the service strategy, which, in turn, defines the institutional structure best suited for program implementation.

## Findings

### Promotion Has Had Positive Impact

Evidence from the survey results strongly suggests that the services provided by promotional institutions have had a positive impact on export growth, foreign investment, and employment. In fact, assisted manufacturing firms have generally outperformed unassisted firms during the 1983-1989 period. And assisted firms in both agricultural and manufacturing firms registered more rapid growth in exports than did nonassisted firms (see figure). Firms have particularly benefited in countries that have recently switched to outward-oriented policies, because promotional institutions have played a role in helping local and foreign firms respond to new opportunities.

Less certain is the impact of promotional institutions on exports at the national level. In fact, promotional institutions were responsible for only about 5 to 30 percent of total national growth in nontraditional exports. The gain in such exports ranged from 4 percent for the IPC to 31 percent for CINDE/PIE (both measured against a base of total growth in nontraditional manufacturing exports), with PROEXAG (an institution promoting nontraditional agricultural exports) in the middle with 12 percent. Consequently, promotional institutions by themselves are not enough to stimulate a substantial increase in nontraditional exports at the national level, unless A.I.D. support is large relative to national exports. Costa Rica's CINDE/PIE, for example, achieved significant impact through large expenditure, whereas IPC produced relatively small impact because it spent much less money targeting a much larger and more established export sector. Promotional programs therefore have the potential to make a major contribution to growth in nontraditional exports at the national level, but only if the sector is beginning to take off and the program is large relative to the export sector.

The promotional institutions examined offered an attractive rate of return to A.I.D. investments conservatively estimated at 25 percent in real terms. This estimate is based on direct, short-term benefits generated by increased exports and employment. The estimate does not include benefits from future investment or spin-off investments from the initial venture, nor does it include benefits derived from the impact of the promotional activities on policies benefits that are difficult to measure but nevertheless important. For example, they can contribute to establishing favorable export-oriented policies by serving as a voice for the export sector. And they can create inroads in a profitable but underexploited sector by identifying new opportunities that encourage path-breaking investment.

### Services Highly Valued by Different Client Groups

Information is the single most important service promotional institutions can provide to speed the investment process. Although market forces influence foreign and local business responses, a sector's timely access to information can speed that process.

However, as already stated, different firms need different types of information, which nevertheless fall into two broad categories: Facts about the market and how it works: For foreign investors, information must focus on the cost of production in the target country, whereas for local exporting firms seeking foreign markets, information must include price data in overseas markets and information on import regulations.

Contact names: Foreign investors need referrals to local professional firms, suppliers, and free zones, whereas local firms need referrals to potential buyers.

Most manufacturing firms (and some agricultural firms selling a specialized product for processing) engage in contract production, and their buyers provide them with the technical assistance they need. However, agricultural firms selling into the fresh food market need technical assistance for production, as well as information, to do well in foreign markets. A.I.D. has been a principal supplier of technical assistance to nontraditional agricultural exporters interested in improving their production for foreign markets.

Service Strategy: Customized for the Few or Standardized for the Many?

Promotional institutions typically provide two types of service: standardized information, which targets a broad clientele, and customized information, which is tailored to the needs of the individual client. Customized service programs tend to be concentrated, because of cost considerations, and standardized programs tend to be diffuse.

Contrary to expectations, both local and foreign firms surveyed repeatedly emphasized the usefulness and importance of standardized information (such as handbooks on market prices and regulations) to their export success. Moreover, from the viewpoint of the promotional institution, standardized information is inexpensive and easy to provide. Local personnel with little experience or specialized knowledge can assemble the information from existing databases, directories, and other readily available sources. But standardized information should not be emphasized at the expense of customized information, particularly technical assistance needed by agricultural firms seeking to improve their production for foreign markets. But with limited funding, many more firms can be provided with standardized information than with technical assistance.

#### Institutional Models

Export and investment promotion services are delivered through different institutional mechanisms. The institutional models differ depending on answers to three key questions: Are the primary clientele foreign investors or local exporters? Will the program primarily provide customized or standardized information? And how important is program sustainability?

The study identified four viable models, representing a range of

options to fit the needs of different target groups and the level of resources available. Examples of the four models are described below.

For investment promotion, a viable model includes the following:  
A government promotional agency with strong ties to the private sector. Such an organization can effectively provide standardized services to foreign investors. (Example: CENPRO)

An independent private organization, which can be effective in providing customized services to foreign investors. (Examples: CINDE, IPC)

For export promotion, the viable models include the following:  
A membership organization, which seems to function well providing local exporters with standardized services, such as buyer contacts. (Examples: GEXPRONT, JACC)

A project implementation unit, which can be effective in supplying specialized technical assistance needed by local firms. (Examples: CAAP, PROEXAG)

Although the study was able to identify viable institutional models for promoting investment and exports, it was difficult to determine which models have greater impact and offer the highest return. A principal reason is that some promotional institutions do not track exports and investments for which they claim credit. In particular, institutions that provide standardized services to many firms fall in this category, because they have little direct contact with the firms they serve.

Some institutional structures have considerable difficulty providing customized services, such as technical assistance for production. Membership organizations seem particularly unsuited to providing customized services for two reasons. First, they have a highly diverse membership with technical needs that vary greatly by product. Second, their members, because of the fees they provide, are unwilling to have services provided to select groups within the membership. Moreover, membership organizations, private institutions, and government agencies usually lack the specialized technical knowledge, expert staff, and funds necessary to provide such services. Also, technical assistance is expensive and sector specific; therefore, such services must be highly targeted, which again eliminates organizations with a divergent membership. It appears that only a donor-funded project implementation unit, or such a unit working in cooperation with a membership organization, is the preferred option for providing customized services, particularly to local firms in need of technical assistance for production.

Finally, some of these models are more sustainable than others. For example, government agencies and membership organizations have a greater capacity to operate independently of a large infusion of donor funds than other models. Independent private institutions and project implementation units often rely principally on outside funding for continuation of the program.

## Fees and Sustainability

One challenge facing A.I.D. managers has been the demands for continued subsidies for the promotional institutions over many years, even though A.I.D. initially expected most of these institutions to become financially self-sustaining in the long term. The study confirms that fee income from such programs is not sufficient to ensure sustainability, nor are increased fees necessarily conducive to establishing a more effective institution. Fee income is a desirable source of support for institutions that work with local exporting firms. For example, in membership organizations, fees provide a means of rationing services, generating income, and building ties to their clientele. Membership organizations might become self-sustaining if they focus on providing standardized services for which costs can be fully recovered. But fees would have to be unreasonably high to provide full cost recovery for an institution offering customized services.

Fee income is less effective, and even inappropriate, for investment-promotion organizations. First, fees would encourage these organizations to target the established sector with greater potential for rapid export growth rather than newer sectors on the frontier. Second, fees would interfere with the credibility of the institution as an impartial source of information for investors, tending instead to favor their paying sponsors. Thus, income from fees does not necessarily lead to sustainable institutions, nor will increased fees lead to more effective service providers.

But long-term sustainability should not be a goal in every instance. Some experts argue that an A.I.D.-supported institution has done its job when a sufficient number of export-oriented firms have become established. Once this has been achieved, the firms themselves will exert pressure for favorable policies and will attract investors through private contacts.

## Lessons Learned

### Policy Environment

The value of promotion comes from helping firms recognize and act on profitable opportunities more quickly than they would on their own. In a negative policy environment, where overvaluation, severe restrictions on imports, and complex investment regulations prevail, profitable opportunities are few and far between a reality that a promotion campaign cannot disguise, much less change. A favorable macroeconomic policy framework, therefore, is a necessary condition for healthy export growth and diversification, and, in a favorable policy environment, promotional support is an important contributing condition to that growth.

### The Challenge of Tracking Results

A problem posing a challenge to donors is that many promotional institutions do not track exports and investments for which they claim credit. Institutions providing standardized services to large

numbers of firms tend to have limited contact with their clients. After they provide the relevant information to the firms, they have no need to follow up on the export or employment performance of these firms. However, institutions providing customized services are more likely to follow the firms' economic performance. Because donors like to have proof of impact, programs providing customized services may be favored over standardized services. The lesson for donors is that programs providing standardized services should not be ignored as an approach to promoting exports and investment, just because it is difficult to attribute impact to such programs. Greater attention still needs to be given to tracking program performance via a monitoring system.

### Working at the Frontier

Firms, whether foreign or local, make investment decisions based on expectations of profit, which are shaped by fundamental factors such as wage rates and foreign exchange policies, not by a sales job. Thus, information, including standardized information on prices and operating conditions, emerges as an important ingredient in a strategy to expand the pool of candidate investors and exporters. But the job of a promotional institution does not end when it has provided its clients with needed information. To be effective, information-based services must operate at the frontier of investment activity. They must be quick to identify profitable niches created by new opportunities and be able to adapt to shifts in policies that can shut a window of opportunity.

Thus, investment promotion and export promotion programs must have the flexibility to encourage investment in new sectors and to assist exporters in sectors with substantial future export prospects.

### The Right Service Provider

Exporters and investors rely on a variety of providers to meet their needs for foreign market information, buyer contacts, or technical assistance. In recent years, donors have attempted to meet these needs in a single full service institution, often combining both investment and export promotion in the same institution. As stated earlier, the needs of the specific clientele drive the service strategy, which, in turn, defines the institutional structure best suited for project implementation. A lesson to be drawn from this study is that no single service provider will be effective in responding to a variety of client needs.

### Sustainability

A.I.D. cannot expect export and investment promotion programs to be financially self-sustaining. Fee income from either program is not sufficient to ensure sustainability, nor are increased fees necessarily conducive to effective service delivery. Charging fees is a realistic option for intermediaries working with local exporters, but not for those targeting foreign investors. A.I.D. should not make financial sustainability a prerequisite for



export and investment promotion programs; rather, it should focus greater attention on the economic rationale for the subsidy.

## Outstanding Issues

### Why Meddle With the Market?

The study presents a number of rationales for meddling with the market or intervening in the service provider market, but it concludes that these rationales are easy to make but very hard to prove or disprove. A challenge for A.I.D. is to examine carefully the economic rationales for intervening in the support services market with such promotional projects. Identifying the economic rationale is particularly important given the study findings that promotional intermediaries are not financially self-sustaining and that buyers in the private sector are critical suppliers of services to firms. The question arises: Are A.I.D.-assisted intermediaries supplanting the private sector as service providers? To ensure that they are not, A.I.D. needs to determine whether the private sector has the capacity to provide such services before it embarks on a promotional program. A.I.D. cannot assume market failure to be a universal state.

### Continual Subsidy or a Sunset Law for Promotional Services?

The study contends that "information-based promotion should arguably continue indefinitely, always seeking to operate at the frontier where a new crop of firms needs assistance." This line of reasoning presupposes that there will always be an economic justification for donors to intervene. However, it ignores the fact that policy improvements may over time stimulate the development of private sector service providers able to respond to the increasing demand from exporters.

It is therefore not clear that indefinite subsidies for such promotional services are always justified. Rather, in many cases, a sunset law assuming a time-limited intervention may be more appropriate.

This summary, by Cressida McKean and Farah Ebrahimi, is based on a report prepared by Nathan Associates and Louis Berger International, Inc. entitled Export and Investment Promotion: Sustainability and Effective Service Delivery (Vol. 1, Synthesis of Findings From Latin America and the Caribbean), A.I.D. Program and Operations Assessment Report (forthcoming). The views and interpretations are those of the authors and are not necessarily those of the Agency for International Development. Any comments or inquiries about the report should be sent to the Office of Evaluation, Center for Development Information and Evaluation, Directorate for Policy, Agency for International Development, SA-18, Room 220 Pubs., Washington, DC 20523-1802.